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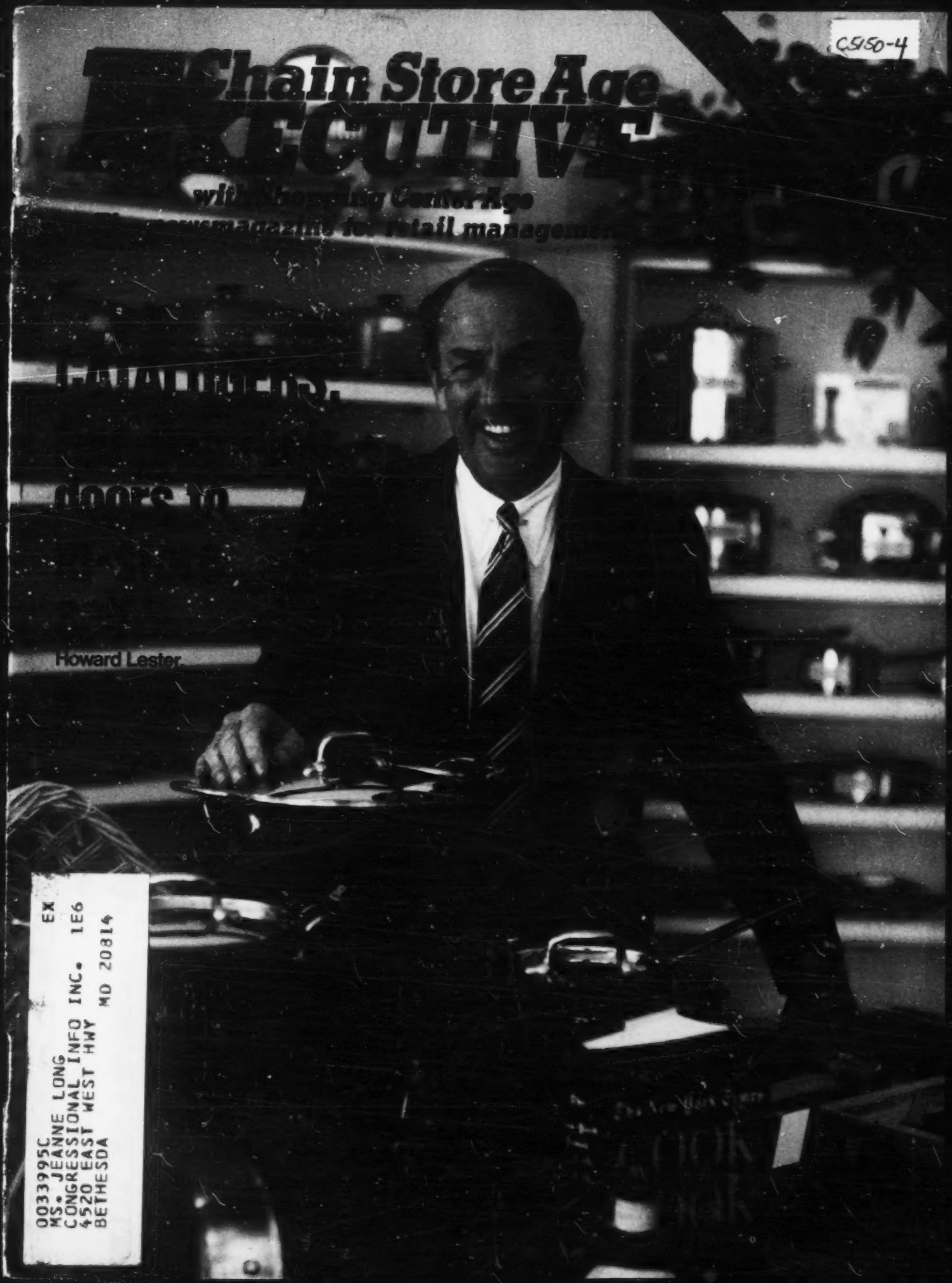
Chain Store Age EXECUTIVE

with Shopping Center Age

...magazine for retail management



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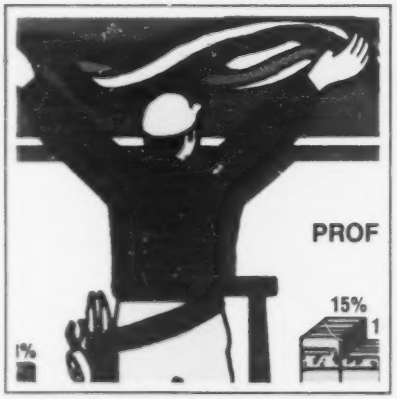
OPENING UP TO IN-STORE SALES

Despite the popularity of direct marketing, some people simply won't shop by mail. That's one of the reasons why many nationally recognized catalogers are seeking a future behind the four walls of retail stores. They include Williams-Sonoma, Lillian Vernon, Eddie Bauer, Royal Silk and The Sharper Image. *18*



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SHOPPING CENTER AGE

OPTIMIZING RETAIL SPACE

Because customers demand them, a variety of mixed-uses, including hotels and even cultural facilities, are today being combined into a single retail entity. The difference, though, is that areas for these uses are being designed as integral parts of centers themselves. *23*

1986: YEAR OF THE REMODEL

CHAINS' EXPANSION CONTINUES IN SPITE OF CURRENT RENOVATION BINGE

Strawbridge & Clothier in Philadelphia plans and executes at least one major remodel a year plus several minor redos.

Perry Drug, based in Pontiac, Mich., has a less rigid formula. It remodels whenever stores need updating, there's a change in merchandise presentation or more or less space is needed.

While the reasons why may differ, Strawbridge & Clothier and Perry Drug exemplify the remodeling binge now under way in the retail industry.

According to the latest annual survey of chain remodeling activity conducted by *Chain Store Age Executive*, 91% of retail chains, covering all major industry classifications, plan to remodel some of their units before year-end. Such remodelings, however, aren't being undertaken at the expense of new store openings.

Safeway Stores, for instance, opened 100 stores in 1985 while closing 125 older units, and plans to open an additional 90 stores this year.

Supermarkets General has a 1986 capital expenditure budget of $200 million, 50% more than in 1985, and plans to open up to 35 stores this year, adding approximately 1.1 million sq. ft., or nearly 13%, to company selling space.

Walgreens, which opened a record 106 stores last year, is planning to open at least 120 more in 1986.

Adams Drug is adding 30 to 40 new stores in 1986 to its current base of 417 units.

The survey looks specifically at remodeling activity in the following retail categories: discount/mass merchandise chains; department stores; supermarkets; drug stores; apparel specialty stores, and home centers. Each of the chains included in the survey is in the top 100 by volume in its merchandise classification in the United States.

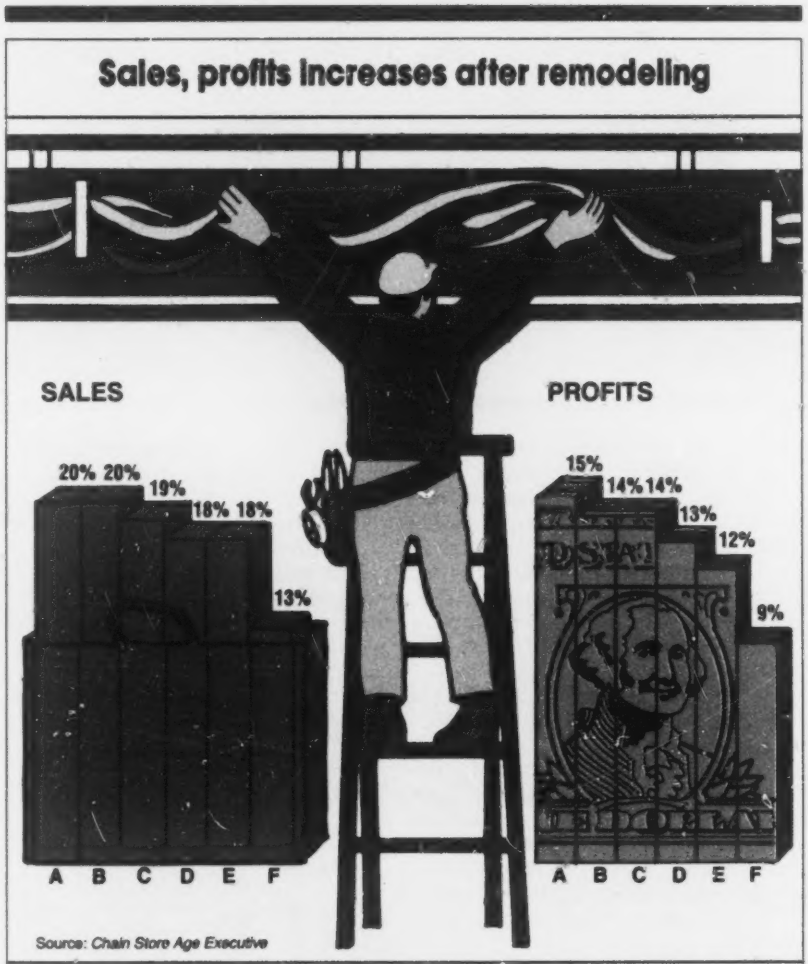
The average square foot cost of a retail remodel was $23 in 1985, but ranged all the way from a low of less than $5 to a high of more than $50.

Store planners point out that the inflation rate remains fairly low (estimated at 3.9%) and therefore there shouldn't be major variations in construction costs this year.

The projected remodeling percentage becomes even more impressive when applied to the entire U.S. retail industry.

According to the 1985-86 *Directory of Leading Chain Stores in the United States*, published by Lebhar-Friedman, there were 6,436 retail chains, excluding restaurants, that operated 241,951 stores last year. If the 91% figure is applied to this group, this translates to over 5,850 retail chains planning to undertake remodeling projects in 1986.

The major reason for the willingness of retailers to invest in such remodels is the increased sales that are generated as a consequence. The survey indicates the following average sales increases: 20% generated by supermarket remodelings; 20% by discount/mass merchandiser remodelings; 19% by home center projects; 18% each by apparel specialty and department remodels; and 13% by drug store remodels.



REMODELING GENERALLY RESULTS IN IMMEDIATE HIKES IN BOTH SALES AND PROFITS. CATEGORIES: (A) SUPERMARKET; (B) DISCOUNT/MASS MERCHANDISER; (C) HOME CENTER; (D) SPECIALTY; (E) DEPT. STORE; (F) DRUG.

Ceilings top longevity list

It may be because no one walks or leans on them, but ceilings have the greatest longevity among specific store areas, according to a survey of store planners and designers.

Ceilings, the participants note, last an average of almost 13 years before remodeling or replacement is needed. Interior furnishings have an average lifespan of 9.2 years, followed by signage with 8.6 years, and floors and/or carpets, 8.3 years.

The discrepancy in average lifespan between ceilings and other interior elements described above may be a bit understated as an additional 17% of respondents report that the ceilings will last indefinitely.

Other noted differences by trade classification are as follows:

- Interior furnishings at apparel specialty stores need replacement significantly more often than do those at any other type of establishment.
- Floors and carpets need replacement most frequently at apparel specialty and department stores, and least frequently at supermarket and drug chains.
- Signage lasts longer at drug, supermarket and apparel specialty stores than at discount/mass merchandisers, department and home centers.

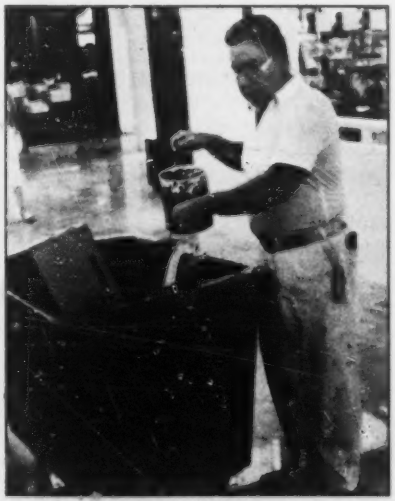
Profit increases ranged from 9% for drug chains to 15% for supermarkets. Those achieved by discount/mass merchandisers and by home centers were both 14%. The apparel specialty chains generated profit increases of 13%, slightly higher than the 12% generated by the department stores.

Among other findings of the study are the following:

- Respondent chains expect to remodel an average of 16 units in 1986, compared with 14 in 1985.
- Expanded remodeling activity in supermarket, apparel specialty and home center chains will primarily be responsible for the projected aggregate increase in remodeled units with 29 remodels scheduled for apparel, 26 for supermarkets and 12 for home centers.
- The proportion of chains planning remodeling for 1987 (75%) is substantially lower than the corresponding proportion for 1986 (91%).
- For the second year in a row, store planners express the opinion that consumers would rather shop at stores featuring less ambience and lower prices than expensively-decorated, higher-priced stores.
- Remodeling is typically completed "all at once," according to 62% of the respondents, rather than in phases, as indicated by 31% among all but the department store chains.
- In contrast, 60% of the department stores say they complete remodeling projects in sequential fashion.
- In 52% of the chains surveyed, the remodeling task is the exclusive responsibility of an in-house department; the remaining chains utilize external services either exclusively (31%) or in conjunction with in-house capabilities (17%).

Reasons for remodeling specific stores are varied, ranging from age of the store (28% of the respondents) and condition (20%) of the facilities, and the desire or need to upgrade (14%) or improve the esthetic appearance (20%) of the stores. Sales growth (22%) and profit potential (18%) are also mentioned by respondents.

Other factors cited as reasons for undertaking remodeling projects include: market conditions, potential/demographic trends (18%); competition (17%); enhancement of merchandise presentation/launch new merchandise/exploit merchandise trends (12%); reallocation of departmental space/change layout (12%); change in strategy, concept, target market (11%).



MALL FACELIFTS: SPURRING 22% OF SURVEY RESPONDENTS TO REMODEL

The decision to remodel is rarely made due to a single factor, as James H. Fowler, assistant vp-facilities planning for Perry Drug, points out. For example, in some cases his company schedules a store for remodeling when space is vacated adjacent to a store that is currently too small. Or there are instances when the existing store is too large and Perry decides to carve out part of the space for another division—auto parts, for example.

Changes in the methods of merchandise presentation are also the impetus for a remodel, he adds.

The major reasons remodelings are undertaken also vary somewhat in relation to different retail classifications. For instance, home center chains are least likely to mention the age or condition of the store as a primary reason for a remodel. They are most likely to be responding to market conditions and changing demographic trends in undertaking such a project.

Discount/mass merchandisers appear less concerned with upgrading and visually improving their facilities than those involved in other areas of retailing.

Department store chains are more likely than others to consider the enhancement of their merchandise presentation in their remodeling decisions.

Analyzing the total survey population, a total of 68% of the respondents indicate that the potential for attracting a broader customer base is extremely important in the decision to remodel, and 53% say creating a new look ranks high on the list of reasons. Remodeling by competition is mentioned by 41%, and remodeling of a shopping center or mall is cited by 22%.

However, analysis of the data also shows that a large portion of the respondents plan to open one or more stores this year.

Specifically, 30% of discount/mass merchandise chains, 60% of the supermarkets, 44% of the drug chains, 33% of the apparel specialty chains and 37% of the home centers plan to open between four and nine stores before year-end. In addition, 53% of the department stores report plans to build one to three stores. ■

ANALYSTS CHERRY PICKING RETAIL STOCKS

EVEN THE ECONOMISTS CAN'T AGREE ON WHAT LIES AHEAD IN 1986

Collapsing oil prices, projected lower interest rates, lower inflation and rising consumer discretionary income all seem to bode well for retailing in 1986.

However, not everyone seems to agree on the direction of the economy. *BusinessWeek* was bullish in the same week that *Fortune* was bearish.

"The outlook for the new year is suddenly a lot different from what most forecasters predicted a couple of months ago. The economy is stronger and shows signs of climbing more steeply," wrote *BusinessWeek*.

In the same week and about the same economy, *Fortune* wrote: "Many economists expect the momentum [of 1985 consumer spending] to last into early 1986—but don't bet on it. Despite that spree, purchases were actually down a touch in the fourth quarter as a whole. With savings low and indebtedness high, consumers are in no shape to keep on buying heavily."

Within the framework of this mishmash, some Wall Street analysts are recommending a fistful of retail stocks for purchase while others grudgingly give the green light to just one stock in a particular retail category.

For instance, Susan C. Schmierer, a retail analyst for L. F. Rothschild, Unterberg, Towbin specializing in supermarket stocks, reached into her grab bag and could come up with only one supermarket chain to recommend as a buy: Bruno's, a Birmingham, Ala.-based chain of 94 food and combo food and drug stores.

The reason for not recommending additional companies, she says, is that there is a heightening of competitive pricing under way in the supermarket industry. For a couple of years, this price competition had been decelerating. Bruno's is being recommended as a growth stock. Unlike many other supermarket chains, it is a dominant factor in the areas in which it operates stores. The chain posted earnings of $24.6 million, or 69¢ a share, on sales of $886.7 million in the fiscal year ended June 30, 1985. Schmierer is projecting earnings per share of 85¢ in the current fiscal year.

Rick Nelson, an analyst for Duff Phelps, says that "Relative to other drug store chains, we are recommending Revco, but we are recommending market waiting at best." He says that Duff Phelps has some concerns about the drug store industry, including competition from the deep discounters, and their ability to cope with disinflation.

He estimates earnings for the fiscal year ending around the end of May will be about $1.65 a share, against $1.55 a share in the year ended June 1, 1985. The company reported fiscal 1985 earnings of $1.06, which included a 49¢ a share inventory writedown of video game cartridges, computer peripherals and other goods purchased by a subsidiary of the firm.

Estimated 5-Year Earnings Growth Reflecting Today's Lower Inflation

	Prev. est.	New est.
Allied Stores	12%	9%
Ames Dept. Stores	22	20
ADG	15	12
Carter Hawley Hale	12	9
Dayton Hudson	16	13
Federated Dept. Stores	12	9
Jamesway	20	18
K mart	12	9
May Dept. Stores	12	9
Nordstrom	20	18
J. C. Penney	11	8
Price	30	28
Wal-Mart	25	23
Zayre	20	18

Source: Dean Witter Reynolds

Jeffrey B. Edelman, vp at Dean Witter Reynolds, says that department store retailing should benefit from a lower inflationary environment. The growth rates of the chains have slowed, but he forecasts them to exceed the growth of the overall economy. Notes Edelman:

- Consumer discretionary income should be on the rise.
- Retailer cost pressures are likely to ease.
- Higher selling prices could close the inflation gap.
- Store expansion is slowing and asset productivity is increasing.
- Profitability should rise and price/earnings ratios are likely to follow.

Relative momentum of department stores has deteriorated sharply over the last few months, says Edelman. Those stocks are becoming more attractive on a near-term basis.

"Average P/E multiples have generally tracked in line with return on equity," he says.

"Our assumption of target price 12 to 18 months out are based on a 14 P/E for the Standard & Poor's 500 on 1986 earnings. Thus, based upon a 9% total return for the overall market potential appreciation plus yield, Associated Dry Goods, Dayton Hudson and Zayre are attractive and are recommended for purchase. K mart and J. C. Penney also stand out, but we carry a much lower confidence factor on those estimates." He estimates earnings per share for the current fiscal year of $3.50 for ADG and Dayton Hudson, $4.30 for Zayre, $4.50 for K mart and $6.25 for Penney.

In the specialty store field, Edward Johnson of Johnson Redbook Service, a division of Prescott, Ball & Turben, is recommending the purchase of Charming Shoppes and The Limited. Among department and discount stores, he's recommending the purchase of stocks of Ames Department Stores, Zayre and Dayton Hudson, which, he says, is on the rebound.

Bernard Sosnick and Mary Kilbride, also of L. E. Rothschild, are recommending the purchase of Allied Stores stock. "Allied is a survivor in the department store field," they say, "and is growing stronger, despite a low-keyed, low-risk approach to business."

The company has several attractive and expanding specialty retailing operations (Brooks Brothers and Ann Taylor among others). Over the next five years, several weak divisions probably will be eliminated, while stronger ones should become more numerous through internal developments and acquisitions.

"This transformation, along with the growth of specialty retailing operations, should enable Allied's stock to sell at parity with its peer group, instead of at its traditional discount. If our perceptions about Allied's prospects for the next few years are correct, we believe the stock will perform well relative to the general market." ■